Fitch Affirms & Removes California from Rating Watch Negative

Fitch Ratings-New York-August 9, 2004: Fitch Ratings has affirmed and removed from Rating Watch Negative the state of California's $33.5 billion general obligation bonds as further financial deterioration is not now expected. Also removed from Rating Watch Negative are about $10 billion bonds issued by several agencies, as listed below, but supported by state resources. The Rating Watch removal ratings on the affected bonds, 'BBB' on all except general obligation veterans bonds ($1.4 billion) which are rated 'A', are affirmed. General obligation economic recovery bonds, rated 'A+', were not on Rating Watch.

California has faced continuing financial problems since fiscal 2002, following a precipitous drop in personal income tax collections and the effects of the recession and lingering economic slowdown. Short term operating debt reached $14 billion, raising concern over the liquidity position. This was allayed with the issuance of $11.3 billion general obligation economic recovery bonds, supported by a one-quarter sales tax, earlier this year. Bond proceeds are being used to fund general fund deficits accumulated by June 30, 2004, and actual use will be spread over several fiscal years.

The budget for fiscal 2005 has now been adopted. As compared with the governor's January recommendations, estimated revenues are up somewhat but the increase in expenditures is greater. Revenues are $3.4 billion below expenditures, with the difference made up essentially from deficit bond proceeds, $2 billion directly and $1.4 billion from opening fund balance, also derived from bonding. The closing balance of $1.6 billion includes $929 million for encumbrances and about $700 million, less than 1% of revenues, for a reserve.

With liquidity restored and an adopted budget with some leeway provided from fund balance, movement toward financial stability is anticipated. However, this year's operating deficit is considerable, even without inclusion of nearly $1 billion expected from pension bonding and over $2 billion in a loan from the transportation fund and diversion of local revenues, and expenditure pressure continues. The state anticipates a budget gap of around $5 billion for fiscal 2006. If a bond issue of around $1 billion representing tribal compact renegotiations is issued, it will be used to pay a transportation loan and is not in the budget for current operations.

Continuing evaluation of California's credit will reflect not only the course of the economy and its effect on revenues but also expenditure control and policies directed toward achievement of structural balance.

Today's actions affect lease obligations issued by the following agencies: Public Works Board, the Franchise Tax Board, East Bay State Building Authority, Los Angeles State Building Authority, Oakland State Building Authority, Riverside County Public Financing Authority, Sacramento City Financing Authority, San Bernardino Joint Powers Financing Authority, San Francisco State Building Authority, Shafter Joint Powers Financing Authority and Taft Public Financing Authority as well as series 2003 B bonds of the Golden State Tobacco Securitization Corporation.

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